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(Installations)**

**BEFORE THE MILITARY INSTALLATIONS AND
FACILITIES SUBCOMMITTEE OF THE
COMMITTEE ON THE ARMED SERVICES
OF THE UNITED STATES HOUSE OF REPRESENTATIVES**

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1:00 p.m.**

Mr. Chairman and distinguished members of the committee, thank you for giving me this opportunity to appear before you today to discuss the status of the Department of Defense's housing and utilities privatization programs. Privatization is a critical tool as we attempt to structure our installations to support the needs of our fighting forces for the 21st century. We are pursuing a multi-part strategy to reshape our installations to match changing military mission requirements. In addition to the housing and utility privatization initiatives, this strategy includes seeking new BRAC authority as well as enhanced out-leasing of underutilized real property and facilities, competitive sourcing of non-inherently governmental functions, and improved standards and conditions for critical facilities. In order to be fully successful in our reshaping effort, the Department must pursue all of these initiatives. No single initiative, or set of initiatives, can substitute for the entire strategy, or for one another. For example, the authorities of the Military Housing Privatization Initiative (MHPI) allow us to leverage military construction dollars with private sector funds in order to quickly improve the quality of life for our Service members. Privatization of our utility systems relieves us of the responsibilities and expenses associated with owning and operating utility systems, and places those responsibilities on the private sector, which can meet those responsibilities more efficiently and effectively. This allows the Department to focus our limited financial resources on modernization and readiness.

Let me discuss these two major ongoing privatization programs in more detail. First, I will report on the status of the Military Housing Privatization Initiative. Then I will bring you up to date on recent developments in our efforts to privatize the utility systems on our installations.

MILITARY HOUSING PRIVATIZATION INITIATIVE

The quality of housing for Service members and their families continues to be a top priority of the Department of Defense. Numerous studies have shown that force readiness depends on retaining high quality personnel who make our armed forces the best in the world. To do this we must maintain their quality of life, and it has been repeatedly determined that quality, affordable housing is a critical element of that quality of life.

Military housing is old, below contemporary standards, and in need of extensive repair. Approximately two-thirds of DoD's nearly 300,000 houses need extensive renovation or replacement. Fixing this problem using only traditional military construction would take 30 years and cost as much as \$16 billion. Recognizing the severity of this problem, Congress, in 1996, enacted the Military Housing Privatization Initiative. This program provides the Department with significant new authorities to use private sector expertise and capital to accelerate improvement of government-owned housing and help us eliminate a serious shortage of quality affordable housing for military members and their families. The process of learning how to best use the new authorities has been difficult and has taken longer than we had hoped but we have made significant progress and are on the verge of making substantive improvements in our housing stock.

GOALS

Three years ago, the Department of Defense established a goal to renovate or replace our substandard family housing units by 2010 using all the tools available. Using our privatization authorities, we can provide higher quality housing both on and off base as well as stretch and leverage the Department's limited housing resources by a factor of at least 3:1. This means we can revitalize three times as many houses as we would with a military construction project for the same amount of money, thus allowing us to solve our housing problem three times faster. Our first two Navy projects, completed in 1997, at Corpus Christi, Texas and Everett, Washington, demonstrated leveraging of 4:1 and 3:1 respectively. This past

summer the Air Force awarded its first housing privatization contract at Lackland Air Force Base. Initially projected to require more than \$20M in budget scoring to provide 420 units of privatized housing, the competition resulted in a project which only required \$6.3M. An equivalent military construction project would have cost \$49.9M, resulting in an 8:1 leverage in upfront budget funds. The tremendous potential of housing privatization program could not be more clear.

DEVOLUTION OF EXECUTION

The housing privatization initiative has seen considerable progress over the last year. Last fall, noting concerns that military construction projects were being held pending privatization decisions, we took steps to speed implementation. We devolved more execution authority to the Military Departments while maintaining basic oversight authority within OSD. The Military Departments prepared detailed implementation plans, which the Department forwarded to Congress in October 1998. We are carefully monitoring these plans, and just last month we sent you our first quarterly progress report. Since last October, we have notified you of proposed solicitations for eleven new housing privatization projects encompassing over 23,000 housing units. These projects put us ahead of schedule to meet our goal of 30,000 privatized units by the end of FY 2000 and will provide a solid basis from which to support a request for permanent authorities next year.

PROJECT STATUS

The Department has increased the pace of the housing privatization program since we provided timelines to Congress last fall.

Six projects totaling over 4,000 privatized housing units are currently in solicitation or about to be awarded. These projects are: Fort Carson, Colorado; Marine Corps Logistics Base, Albany, Georgia; Marine Corps Base Camp Pendleton, California; Robbins Air Force Base, Georgia; a second project at Naval Station Everett, Washington; and, a second project at Naval Air Station Kingsville, Texas.

We have also notified Congress of plans to issue solicitations for more than 21,000 military housing units at seven other sites: a Navy regional project in South Texas; a Navy regional project in San Diego, California; Naval Air Station Lemoore, California; Naval Station New Orleans, Louisiana; Naval Air Station Brunswick, Maine; Fort Hood, Texas; and Elmendorf Air Force Base, Alaska.

In addition to all of the solicitations that have already either been issued or submitted to Congress for notification; the Services are currently developing nine other solicitations and are in the process of determining the feasibility of privatizing housing units at 26 other sites that they have on their site nomination lists.

FAMILY HOUSING IMPROVEMENT FUND (FHIF)

For the first time since its creation in 1996, and per an agreement we reached with Congress last fall, the Department is requesting a direct appropriation to the Family Housing Improvement Fund (FHIF). In the past, the Department requested authorization and funding for a military construction project at a location under consideration for privatization. Once the military department decided to pursue privatization at that location, it would transfer the funds from the family housing construction accounts into the FHIF. However, the Department's FY 2000 budget identifies privatization projects directly in the Family Housing Improvement Fund; \$76.7 million for seven privatization candidates. Additionally, the Department requests \$2 million in FY 2000 for residual overhead and program costs that remain, primarily covering continued consultant support in developing program oversight techniques for project and loan monitoring following project award.

The Military Departments have been working hard to speed up the privatization process and to expand the housing privatization program. For example, the Navy has developed templates for its solicitation documents to ensure consistency across its program and to shorten lead-time in preparing those documents. The Army is using the Request for Qualifications process, which promises innovative projects and reduced solicitation times. Additionally, the Office of Management and Budget recently provided scoring guidelines which permit the Department to revisit projects to privatize unaccompanied housing as well as family housing.

A look at the projects about which we have notified you since last October illustrates the power of the Military Housing Privatization Initiative compared to traditional military construction (MILCON). These projects encompass 16,000 housing units. The upfront budget scoring cost to privatize these units is expected to be approximately \$236 million. Using military construction, we estimate these projects would have required \$1.3 billion in family housing MILCON. This comparison

demonstrates the incredible potential that privatization has to offer the Department and the American taxpayer. I want to thank this committee again for your strong support, leadership and understanding as we address our housing problem. I ask for your continued support for this vital initiative. I will now move on to my discussion about the privatization of the Department's utility systems.

UTILITIES PRIVATIZATION

Through a Defense Reform Initiative Directive (DRID), Secretary Cohen directed the Military Departments to privatize all of their electric, natural gas, water and wastewater utility systems by September 2003, except where privatization is uneconomical or unique security reasons require ownership by the Department. Section 2688 of Title 10, United States Code, authorizes the military departments to convey all utility systems under its control, including electric, water, waste water, natural gas, steam, hot and chilled water, and telecommunications systems to a utility company or other entity. The Department is currently focusing specifically on the privatization of its electric, water, wastewater, and natural gas utility systems. The objective is to get DoD out of the business of owning, operating, and maintaining these systems. As a result of this DRID, the Military Departments are considering over 2,300 utility systems for privatization.

GOALS

The Department consumes over 70 percent of all energy used by the entire federal government, spending nearly \$6 billion a year. DoD spends \$2.4 billion of this on installations. This consumption represents tremendous procurement leverage, yet, in the past, the Department has devoted excessive management attention and funding towards the operation and maintenance of its own large utility infrastructure. Taking a lesson from industry, the Department can better meet its requirements by relying on the private sector to own, operate, and maintain utility infrastructure and concentrating its management focus on energy/commodity use and cost. Industry competition for both the conveyance of the utility infrastructure and the resulting acquisition of utility service is key to the effective management of the substantial resources directed toward the DoD energy requirement.

STATUS

The September 2003 goal is the Department's new objective resulting from taking a hard look at the task before us and the experience gained from privatization efforts to date. Initially the DRI directed the privatization of all systems (in the four categories mentioned above) by January 2000. As the Services reviewed their inventories, including both major and minor installations worldwide, the scope grew from approximately 740 systems to over 2,300 candidate systems. This increase in quantity coupled with the realization of the challenges inherent in privatizing utilities resulted in a reevaluation of the January 2000 goal. DRI Directive (DRID) 49 was signed by Deputy Secretary Hamre on December 23, 1998, resetting the timeline for utilities privatization to that discussed above. The Services have now submitted revised plans targeting the award of privatization contracts for all utility systems by September 2003. To monitor success, two major interim milestones will be tracked: 1) all analysis studies will be completed by September 30, 2000 and, 2) all solicitations will be released no later than September 30, 2001.

DRID 49 also issued the OSD utility systems privatization guidance establishing the criteria for exempting systems from the privatization program. Where privatization does not have a long term economic benefit, systems may be exempted. Additionally, operational impact must be minimized and national security assured. Each system's potential for privatization must be weighed against these economic and security considerations. It also provides basic parameters for the economic analysis, and reiterates and expands upon the statutory requirements for the use of competitive procedures.

FUTURE ACTIONS

Utility privatization carries with it a number of inherent challenges. While there are many, three areas are critical to the success of this initiative: managing the initial privatization cost; eliminating utility service contract term limitations; and using MILCON funding to facilitate privatization.

Privatization of utility systems requires an up-front investment by the Department. Early estimates are that if the military departments pursue privatization on a single system basis, the economic, technical, environmental assessments, and actual solicitation cost for each utility system is approximately \$320K. These estimates are based on looking at each system, one at a time. Bundling or grouping of systems and installations is being pursued to decrease these costs. In fact, we have initiated a Texas joint regional pilot effort using the Defense Energy Support Center of the Defense Logistics agency as the lead. Eleven installations are involved and the objective is to increase the Department's negotiation leverage while minimizing the contract administration workload. Through this and similar efforts at the Service level,

current budget estimates for the upfront cost are less than \$300M or approximately \$130K per system.

Another fundamental challenge to making economical utility privatization transactions is the ability of the utility purchaser to amortize the cost of and the amount of investment it must make in the utility system over the life of a corresponding contract to provide utility services to the installation from which it purchased the utility system. The law currently restricts the length of utility service contracts to only ten years, while the life of most utility systems is in excess of 30 years. This limitation forces the purchaser of the utility system to amortize the cost of that system as well as any investment it must make to improve the system, over just 10 years, substantially increasing the cost of privatization to the military department. The Department is proposing legislation that would authorize it, in connection with the privatization of a utility system, to enter into utility service contracts with terms not to exceed 50 years, thereby giving all parties the flexibility to make economically sensible transactions.

Often our utility systems are in such poor condition, even from a safety perspective, that they require significant initial capital investment. In the National Defense Authorization Act for Fiscal Year 1997, Congress authorized the Air Force to use military construction funds for a demonstration utility privatization project at Youngstown Air Reserve Station in Ohio. Because the Air Force was permitted to put "seed" money towards this privatization effort, Youngstown today has a new, privately owned underground electric utility distribution system that is fully compatible with the local utility system and is supported by a greater pool of manpower and equipment availability. In light of the success of this demonstration project, the Department is requesting that Congress amend the utility privatization authorization to permit the military departments to use previously appropriated military construction funds to facilitate its utility privatization effort. Using previously appropriated, and otherwise lost military construction dollars to have the private sector transferee improve a utility system will facilitate the transfer to private ownership and save the Military Department money in the long run through lower utility costs.

I solicit your support in addressing these impediments to utility privatization. Later this month I will submit to Congress a report outlining, in greater detail, the Department's use of Section 2688 to include the criteria used for selecting systems for privatization.

CONCLUSION

The military housing and utility systems privatization programs are critical to improving the quality of life, readiness, and modernization of our armed forces. The Department recognizes that the private sector has a great deal to offer us in the way of financing and expertise. There is no need for the Department to continue duplicating the expertise and efforts that the private sector is so willing and able to provide. Yes, the private sector will benefit from these programs, but more importantly, we will all benefit.

The potential of both privatization programs is staggering. The Department is working hard to make these privatization programs a success and we will be looking to you in the years to come for your continued support.

I stand ready to answer any questions you may have.